



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

DRAFT

Date Amended:	8/23/04	Bill No:	SB 17
Tax:	Property	Author:	Escutia
Related Bills:			

BILL SUMMARY

This bill would:

- Require the Franchise Tax Board to furnish the Board of Equalization (Board) with the name and address of any entity that does not respond to a question concerning change in ownership on partnership, bank, and corporate tax returns. §64
- Increase from 45 to 60 the number of days a legal entity has to report to the Board a change in ownership or change in control occurring under Section 64 (c) or (d). §480.1(b), §480.2(b) and §482(b)(1)
- Establish a penalty if a legal entity does not file a change in ownership statement with the Board within 60 days after the date that a change in control or change in ownership occurs. §480.1, §480.2, and §482(b)(1).
- Establish a penalty if a legal entity willfully misrepresents information or willfully fails to disclose information on the change in ownership statement to avoid reassessment. §480.1, §480.2, and §482(b)(1)
- Require legal entities to provide information, records, and documents necessary to ascertain if the legal entity has undergone a change in ownership or change in control under Section 64 (c) or (d) upon the written request of the Board or the assessor. §480.1(e) and §480.2(e)
- Provide that the Board or the assessor may issue subpoenas for the attendance of witnesses or the production of information or records, if any person fails to provide required information or records for the purpose of securing change in ownership information. §486

Summary of Amendments

Since the previous analysis the amendments to this bill:

- Delete the provisions that would have required publicly traded companies to file annual real property statements with the Board and impose a penalty for failure to do so. §471
- Delete the legislative findings and declarations related to the difficulties in identifying changes in ownership of commercial and industrial properties owned by legal entities. *Uncodified language*
- Add a requirement that legal entities provide information, records, and documents necessary to ascertain if the legal entity has undergone a change in ownership or

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change in control under Section 64 (c) or (d) upon the written request of the Board or the assessor. §480.1(e) and §480.2(e)

ANALYSIS

A. Change In Ownership – Legal Entities

Current Law

Under existing property tax law, real property is reassessed to its current fair market value whenever there is a “change in ownership.” (*Article XIII A, Sec. 2; Revenue and Taxation Code Sections 60 - 69.5*)

Revenue and Taxation Code Section 64 sets forth the change in ownership provisions related to the purchase or transfer of **ownership interests in legal entities** that own real property. Generally, when real property is owned by a legal entity, the purchase or transfer of ownership interests in that legal entity **does not** trigger a change in ownership of the property.

An exception to this general rule is when there is a “**change in control**” of the legal entity or upon the transfer of more than 50% of “original coowners” interests.

- Subdivision (c) of Section 64 generally provides that a “change in control” occurs when **one person** or legal entity **acquires more than 50 percent** of the ownership interests in the legal entity.
- Subdivision (d) of Section 64 provides that if real property was excluded from a change in ownership when transferred into a legal entity under Section 62(a)(2) and the holders of the ownership interests became “original coowners” the subsequent transfer of more than 50% of those original co-owner’s shares results in a change in ownership of the real property that was previously excluded.

Proposed Law

This bill would not modify change in ownership definitions as they relate to legal entities. However, it would strengthen change in ownership reporting requirements and penalties in order to aid the discovery of changes in ownership that occur under existing law.

B. Self-Reporting of Legal Entity Changes in Ownership

Current Law

Under existing law, Sections 480.1 and 480.2 require a legal entity to file a change in ownership statement with the Board within 45 days of whenever a change in control or change in ownership under Section 64(c) or (d) occurs. However, the law does not impose any penalty if the legal entity does not report the change in ownership within the 45-day period. (Currently, penalties in existing law apply when a legal entity does not timely respond to a Board request to file a statement, as noted below.)

Proposed Law

This bill would extend from 45 to 60 the number of days a legal entity has to file a change in ownership statement with the Board after a change in control or change in ownership under Section 64(c) or (d). In addition, this bill would establish a penalty if the legal entity does not independently report the change in control or change in ownership to the Board within 60 days of the date of the event. The penalty would be the greater of :

- \$1,000 on each property subject to subject to reassessment, or

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- 10% of the taxes applicable to each new base year value

C. Board Requests to File Change in Ownership Statements

Current Law

The law requires that the Board participate in the discovery of changes in ownership and changes in control of legal entities under Section 64(c) and (d). These reassessable events are not evidenced by a recorded document, which is normal means for discovering changes in ownership of real property. To help discover unreported changes in ownership and changes in control of legal entities, information is annually requested on the state income tax return as required by subdivision (e) of Section 64. The Franchise Tax Board transmits to the Board the information provided by taxpayers on the tax return. Based on these responses, the Board sends a change in ownership statement to legal entities to determine if property it owns in California should be reassessed. In addition, the Board sends statements to legal entities to complete and file based on information it obtains from monitoring business publications and referrals from local assessors.

The law requires that a legal entity complete and file a change in ownership statement whenever the Board makes a written request. A penalty applies if the statement is not filed within 45 days of the request. The penalty is:

- 10 percent of the taxes applicable to the new base year value reflecting the change in control or change in ownership of the real property owned by the legal entity, *or*
- if no change in control or change in ownership occurred, 10 percent of the current year's taxes on that property shall be added to the assessment made on the roll.

The penalty for failure to respond to a Board written request applies whether or not it is determined that a change in ownership actually occurred. However, the penalty is automatically extinguished if the person or legal entity files a complete statement no later than 60 days after the date on which the person or legal entity is notified of the penalty.

Proposed Law

This bill would establish a penalty if a legal entity that files a change in ownership statement after a Board request willfully misrepresents or willfully fails to disclose information on the statement in order to avoid reassessment. The penalty would be the greater of:

- \$2,500 on each property subject to subject to reassessment, or
- 25% of the taxes applicable to each new base year value

This penalty could also apply to any statement that was independently filed by the legal entity.

This bill would not change the requirement to complete and file a change in ownership statement after a written request by the Board. Nor does it change the penalty structure, or automatic abatement provisions, for not timely filing a statement after a written request. This bill would specify that the penalty levied for failure to respond timely to a Board inquiry is separate from any penalty that may be levied on the legal entity for its failure to timely self-report a change in ownership had one occurred.

This bill would update the statutorily required “Important Notice” sent with the change in ownership statement to reflect the new penalty provisions. It would also move to Section 482(b)(2) the requirement that legal entities complete and file a statement upon the request of the Board, which is currently referenced in the statutorily required “Important Notice” portion of the change in ownership statement. Thus, the “Important Notice” language would be limited to the requirement to self-report within 60 days of a reassessable event.

In addition, this bill would amend Section 64 to require the Franchise Tax Board to furnish the Board with the name and address of any entity that does not respond to the change in ownership question on partnership, bank, and corporate tax returns.

D. Information Requests

Current Law

Under existing law, Sections 480.1(e) and 480.2(e) provide that the Board or assessors may inspect any and all records and documents of a legal entity to ascertain whether a change in ownership or change in control of the legal entity under Section 64 (c) or (d) has occurred. Upon request, the legal entity is required to make these documents available to assessment officials during normal business hours.

Section 481 provides that all information that is requested by the Board or the assessor related to change in ownership reporting or which is provided in the change in ownership statement be kept confidential and is not open to public inspection as a public record.

Section 484 provides the assessor with a variety of mechanisms to secure change in ownership information, including the authority to seek a court order to require persons refusing to provide information or records to provide the information pursuant to Section 468. Government Code Section 15613 provides that the Board may issue subpoenas for the attendance of witnesses or the production of books, records, accounts, and papers.

Proposed Law

This bill would amend Section 480.1(e) and 480.2(e) to provide that upon the written request of the Board or the assessor, legal entities provide information, records, and documents to ascertain if the legal entity has undergone a change in ownership or change in control.

This bill would add Section 486 to provide that the Board may issue subpoenas pursuant to Government Code Section 15613 for the attendance of witnesses or the production of information or records to secure change in ownership required for assessment purposes or securing real property ownership information pursuant to newly added Section 471.

In General

Legal Entity Change in Ownership - Discovery

The Board of Equalization’s Legal Entity Ownership Program (LEOP) was formed to assist in the discovery of changes in control and ownership of legal entities pursuant to subdivisions (c) and (d) of Section 64 of the Revenue and Taxation Code.

The LEOP unit assists assessors in discovering changes in ownership or control that might not otherwise be captured by a county’s own discovery systems. Discovery of these changes can be difficult because ordinarily there is no recorded deed or notice of a transfer of an ownership interest in a legal entity.

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LEOP Operations

- Receives a list from the Franchise Tax Board of legal entities that have reported a change in ownership on their income tax returns or have left the question blank.
- Monitors business publications, such as *Mergers & Acquisitions* and the Wall Street Journal.
- Sends a "Statement of Change in Control or Ownership of Legal Entities" to each entity. <http://www.boe.ca.gov/proptaxes/leop.htm>
- Analyzes completed statements to determine whether there has been a change in control or ownership.
- Notifies county assessors of changes in control and ownership.

Background

The Legal Entity Ownership Program (LEOP) started in January 1983 as a result of Chapter 1141 of the Statutes of 1981 (AB 152). The resulting Sections 480.1 and 480.2 of the Revenue and Taxation Code require the Board to participate in the discovery of changes in control of corporations, partnerships, and other legal entities. It was recognized that such events, which are not evidenced by a recorded document, would fall outside the parameters of assessors' normal means for discovering changes in ownership.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the Pacific Institute for Community Organization (PICO) www.PICOcalifornia.org and the California Tax Reform Association www.caltaxreform.org. Its purpose is to ensure that legal entities properly report changes in ownership.
2. **Key Amendments.** The **August 23** amendments (1) modify the provisions where the Board or the assessor could request legal entities to provide additional information to determine if a change in ownership had occurred; (2) delete monetary penalties for failure to provide such information to address concerns raised by opponents to this provision that counties would make onerous information requests to raise revenue by levying penalties; and (3) limit penalties for "misrepresentation" of information on change in ownership statements to willful misrepresentation or willful failure to disclose information to avoid reassessment. The **August 12** amendments deleted a provision that would have required publicly traded companies to annually report their real property holdings to the Board. Instead, the bill was amended to specify that legal entities, upon request of an assessor or the Board, provide ownership information in order to determine if a change in ownership, as defined under existing law, has occurred. In addition, it deleted legislative intent language unrelated to the bill as amended and restated the legislative intent language as it relates to change in ownership reporting. The **June 26** amendment, relating to the requirement that publicly traded companies annually report their real property holdings, provides that acquisitions of property during the year are to be listed, limits the reporting of leased property, and provides that if the statement is filed but some parcels of real property are not listed, the 10% penalty only applies to the properties that were not listed. The amendment also restores the Board's ability to request that legal entities file change in ownership statements upon written request and levy penalties for failure to respond, and adds a provision that the Board may subpoena information and records to secure change in

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ownership information. The **May 22** amendment, relating to the requirement that publicly traded companies annually report their real property holdings, specifies the date, December 31, as of which all real property holdings for the year would be reported for the following year. The amendment also provides that the penalty for failure to provide a complete statement would not be imposed as a result of a reasonable error or omission on the statement that is filed. The **May 14** amendment provided that any penalties levied on a legal entity for failure to file a change in ownership statement would be added to the assessment roll, as current law provides. (The April 21 amendment would have transferred any penalty monies from local governments to the Board.) The **May 6** amendment provided that when the Board receives real property statements from publicly traded companies, it would transmit any relevant information contained in the statement to the assessors of the counties in which the affected property is located. The **April 21** amendments added the requirement that publicly traded companies annually file real property statements with the Board and modified the requirements and penalties for legal entities to file a change in ownership statement with the Board after a legal entity change in control. See the prior analysis of the 12/02/02 version of the bill for a full discussion of change in ownership of property owned by legal entities.

3. **Changes in ownership or control of a legal entity triggered due to transfers of ownership interests in legal entities (Section 64(c) and (d)) are not easy to discover.** Unlike transfers of interests in real property, a deed is not recorded with the county recorder nor is there any other type of public notice that the Board or the assessor could use to monitor and track transfers of ownership interest in a legal entity.
4. **The law requires legal entities to report a change in ownership under Section 64(c) and (d) by filing a change in ownership statement within 45 days of the event, but there is no penalty if they fail to do so.** Under current law, a penalty is incurred only if a legal entity does not respond to a written request by the Board to file a statement and the entities are given two opportunities to provide information before a penalty is levied. This bill would establish a penalty upon those entities that do not initiate filing a change in ownership statement within the required time period. It would additionally extend the number of days for legal entities to report the change in ownership from 45 to 60 days.
5. **In contrast to the income tax returns for income tax purposes, the requirement to file a change in ownership statement for property tax purposes is not widely known or understood.** Legal entities may not file statements, in part because the legal entity may not understand that for California property tax purposes, transfers of ownership interests in the legal entity have triggered a change in ownership. It is especially difficult for property tax administrators to discover changes in ownership of property that occur under Section 64 (d). These properties have been previously excluded from change in ownership under Section 62(a)(2). They fall into a special class that requires that cumulative transfers of interests in the legal entity be tracked to determine when more than 50% of the total interests in the legal entity have been transferred. At that point, the legal entity must report the change in ownership and the property previously excluded from change in ownership is subject to reassessment.

6. **As an aid in discovering changes in ownership of property owned by legal entities, the Board routinely sends statements to legal entities based on information from the property tax question on the state income tax return and from monitoring various business publications.** This bill would not modify the requirement to file a statement upon Board request and the penalty for failure to respond to the Board request for information. These penalties can apply whether or not a change in ownership actually occurred.
7. **The Franchise Tax Board currently informs the Board of legal entities that leave the property tax questions blank on their income tax returns.** This provision would codify existing administrative practices.
8. **This bill would establish a minimum penalty of \$1,000 per property for not timely reporting a change in ownership.** If it is ultimately discovered that a change in ownership of a legal entity occurred, which the legal entity did not self-report, this bill would allow a penalty to be levied. Determining whether the flat penalty or the percentage penalty applies is calculated at the level of each property owned by the legal entity subject to a penalty provision. Generally, the flat amount of \$1,000 would apply on any real property with a value of less than \$1 million in current fair market value (or less than \$1 million in factored base year value where no change in ownership occurred). One thousand dollars is greater than 10% of the taxes on a property with a new base year value of \$1,000,000 or less.

$$\$1,000,000 \times 1\% \text{ tax rate} = \$10,000 \text{ tax}$$

$$\$10,000 \times 10\% = \$1,000 \text{ penalty}$$

For instance, a legal entity could own one property or 100 properties in California. If a legal entity had four properties each with a fair market value of less than \$1,000,000, the total penalties would be \$4,000. If it had 50 properties statewide, each less than \$1,000,000 in value, the total penalty would be \$50,000. For each property, the penalty would be the greater of \$1,000 or 10% of the tax, so for any property over \$1,000,000 the penalty would switch to the 10% calculation. For example, a \$5,000,000 property would result in a \$5,000 penalty.

$$\$5,000,000 \times 1\% \text{ tax rate} = \$50,000 \text{ tax}$$

$$\$50,000 \times 10\% = \$5,000 \text{ penalty}$$

9. **Information Requirements.** The amendments to Section 480.1 and 480.2 would allow the Board or the assessor to request that legal entities provide information to determine if a change in ownership under Section 64(c) or (d) has occurred. Currently, this section of law states that the Board or assessor must travel to the location where the information might be held, which could be out of state or out of the county, in order to view such information. Any information acquired would be required to be kept confidential.

COST ESTIMATE

This Board would incur minor costs (less than \$10,000) to modify the change in ownership statement and related documents for legal entities

REVENUE ESTIMATE

This measure has no direct revenue impact. Establishing a penalty for not self-reporting a change in ownership statement may be an incentive for legal entities to properly file a change in ownership statement when a change in ownership occurs. In addition, increased penalties may also be an incentive for legal entities to properly file a change in ownership statement when a change in ownership occurs.

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